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In The
Supreme Court of the United States
October Term, 1991

Norwest Bank Duluth, N.A.,
Petitioner,
v.
Minnesota Commissioner of Revenue
and the State of Minnesota,
Respondents.

Cambridge State Bank, et al.,
Petitioners,
v.
Minnesota Commissioner of Revenue,
Respondent.

On Petition for Writ of Certiorari To The Minnesota Supreme Court

PETITIONERS' REPLY BRIEF

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PETITIONERS' REPLY BRIEF

The Petitioners respectfully submit this Reply Brief in response to the Brief in Opposition filed by Respondents.[1]

I. The Minnesota Supreme Court's Denial of Retroactive Relief Raises a Substantial Federal Question.

Respondents observe that the instant case is "unlike" *Harper v. Virginia Dept. of Taxation*, 401 S.E.2d 868 (Va. 1991), *vacated*, 111 S.Ct. 2883 (1991), *on remand*, 410 S.E.2d 629 (Va. 1991), *cert. granted*, 60 U.S.L.W. 3770 (1992), because the state court in *Harper* applied *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), on a prospective-only basis, whereas in the instant case the Minnesota Supreme Court rejected prospective-only application of *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). (Resp. Br. 7-8.) Respondents then suggest that the "federal issues left unresolved by *McKesson* and *Beam* in connection with intergovernmental immunity cases are more fruitfully addressed in a case such as *Harper*." (Resp. Br. 8.)

In fact, the "federal issues left unresolved by *McKesson* and *Beam*" are squarely presented in this case in a way that indeed differs from *Harper*, but in a way that clearly merits a grant of certiorari. Both *Harper* and the instant case were remanded in light of *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). The Virginia Supreme Court employed prospectivity as a "choice-of-law principle" to defeat Harper's claim. The Minnesota Supreme Court, by contrast, employed prospectivity as a "remedial principle" to defeat Petitioners' claims. (Resp. Br. 27.) Of course, to a taxpayer who is unable to recover an unconstitutional tax the

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[1] Reference is made to the Rule 29.1 Statement of Petitioners included in their petition for certiorari. The statement remains accurate without amendment.

effect of the application of either principle is the same. Indeed, in this case the Minnesota Supreme Court, thwarted by *Beam* from reaffirming its original holding in which it employed choice-of-law prospectivity, simply relabeled its holding as remedial. While this Court has distinguished the two principles in its recent decisions, *compare Beam and American Trucking Ass'ns, Inc. v. Smith*, 496 U.S. 167 (1990) (choice-of-law prospectivity) *with McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990) (remedial prospectivity), the Court did not intend to allow the state courts to subvert choice-of-law prospectivity principles through the awarding of a prospective-only remedy, which is what the Minnesota Supreme Court did in this case.

In *McKesson*, this Court held that purely prospective relief from the imposition of an unconstitutional tax is a denial of due process *if* the state does not provide a "clear and certain" predeprivation remedy. As construed by the Minnesota Supreme Court, Minnesota law provided a "clear and certain" predeprivation remedy in the form of an appeal to the Minnesota Tax Court. (App. 9A-10A.) Citing the purported availability of this procedure, Respondents leap to the conclusion that "the threshold requirement for retroactive relief of any sort cannot be established . . . under *McKesson*." (Resp. Br. 14.) They also assert that "any due process issues which might otherwise be raised by the denial of refunds are obviated by the availability of a predeprivation right to challenge payment of the tax." (Resp. Br. 7.) Respondents conclusions, however, are based upon a gross misreading of *McKesson*.

The holding of *McKesson* is that retroactive relief *must* be provided if there is no prepayment procedure. Respondents have

taken this holding and inverted it. They claim *McKesson* stands for the proposition that retroactive relief can *always* be denied if a prepayment procedure exists. Indeed, according to Respondents there are no due process constraints at all in this situation. (Resp. Br. 7.) This inverted proposition, however, finds no support in the decision itself.

Respondents refer the Court to *McKesson's* footnote 21, wherein the Court stated that "the availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process Clause." 496 U.S. at 38 n.21. (Resp. Br. 10-11.) However, it is clear that the Court in footnote 21 was simply reaffirming the constitutionality of the common law rule that precludes refunds of a voluntarily paid tax. Minnesota, like the Federal Government, has abandoned this common law rule by adopting a refund statute permitting the recovery of a tax even if it is voluntarily paid.[2] (Pet. Br. 16.) Petitioners, who fully complied with the Minnesota refund statute, assert that they had a protectible property interest in the remedy allowed by the statute and that the Minnesota Supreme Court denied them due process by awarding prospective-only relief. (Pet. Br. 15-18.)

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[2] Congress abandoned the common law requirement of protest and duress in 1924. Revenue Act of 1924, c. 234, 43 Stat. 253, 343, § 1014 (1924). Describing the intent underlying the allowance of refunds for voluntarily paid taxes, Justice Cardozo noted that the act righted "an ancient wrong . . . A high-minded government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience." *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373, 379 (1933). A number of states in addition to Minnesota have similar refund statutes. (Pet. Br. 15.)

Neither *McKesson* nor any other decision of this Court has considered the entitlement to refunds where a state, following the federal income tax model, provides parallel prepayment and postpayment tax controversy procedures. *Harper* will not address this issue because the state court in *Harper* applied its concept of choice-of-law retroactivity without addressing the remedial issues. (Pet. Br. 8-10.) Thus, Respondents are wrong in asserting that the "federal issues left unresolved by *McKesson* and *Beam* . . . are more fruitfully addressed" in *Harper*, and they are wrong in claiming that "this case does not raise significant constitutional issues." (Resp. Br. 8.) The Minnesota Supreme Court has employed its notion of remedial prospectivity -- based on professed "equitable and reliance interests" -- to eviscerate this Court's holdings on choice-of-law prospectivity.[3] (Resp. Br. 27.) Whether a state court may do so without violating the Due Process Clause (and, in this case, the Supremacy Clause) *is* a substantial federal question that should be addressed by this Court. Accordingly, Petitioners request that the Court grant certiorari in this case, as it already has in *Harper*, to consider fully in the context of the intergovernmental immunity doctrine the right of a state to deny retroactive relief to a taxpayer who pays an unconstitutionally discriminatory tax.

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[3] Respondents persist in claiming a reliance interest without identifying any legal precedent upon which they might have relied. In fact, both Minnesota and federal cases prior to *Memphis Bank* had struck down state taxes that discriminated against federal obligations. *See State v. Duluth M. & N. Ry. Co.*, 207 Minn. 618, 292 N.W. 401 (1939), *reh'g denied*, 207 Minn. 637, 292 N.W. 411 (1940), *cert. denied*, 311 U.S. 719 (1940) (invalidating Minnesota tax that discriminated against federal obligations); *Schuykill Trust Co. v. Pennsylvania*, 296 U.S. 113 (1935) (holding that a state tax may not be imposed on federal obligations unless it is equally imposed on obligations issued by the state or any other person).

II. The Petitioners Did Not Have a "Clear and Certain" Prepayment Remedy.

Under Petitioners' primary contention, as discussed above, the Minnesota Supreme Court was obligated to recognize and give effect to Minnesota's refund statute. The existence or nonexistence of a prepayment remedy is irrelevant to this issue. Petitioners have argued in the alternative, however, that the instant case can be decided squarely under *McKesson* because the predeprivation remedy that Respondents claim was available to Petitioners -- appeal to the Minnesota Tax Court -- was not a "clear and certain" remedy for the 1979 taxable year at issue. (Pet. Br. 18-20.) An appeal to the Tax Court could not have been brought by Petitioners after the decisions in *Matter of McCannel*, 301 N.W.2d 960 (Minn. 1980) and *Guilliams v. Commissioner of Revenue*, 299 N.W.2d 138 (Minn. 1980), which held that the Tax Court had no jurisdiction to decide constitutional issues in cases filed initially in that court.[4] (Pet. Br. 18-19.) Respondents nonetheless claim, citing *Nagaraja v. Commissioner of Revenue*, 352 N.W.2d 373 (Minn. 1984), and *Erie Mining Co. v. Commissioner of Revenue*, 343 N.W.2d 261 (Minn. 1984), that for the year at issue "Minnesota law clearly allowed an appeal to its tax court *without* prepayment." (Resp. Br. 14.)

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[4] Respondents claim that "prior to 1980" the Tax Court would have had jurisdiction. (Resp. Br. 12.) However, Petitioners did not file their 1979 tax returns until 1980, and the Commissioner would not have issued an order assessing tax until some considerable time after filing. Such an order was a prerequisite to Tax Court jurisdiction. Minn. Stat. § 271.06, Subd. 1 (1980). Thus, Respondents' point with respect to pre-1980 law is irrelevant. Moreover, it would be incorrect to conclude that the Tax Court offered a "clear and certain" prepayment remedy prior to 1980 since the Minnesota Supreme Court questioned the Tax Court's constitutional jurisdiction in a 1977 case. *See Harris v. Commissioner of Revenue*, 257 N.W.2d 568, 569 n.1 (Minn. 1977).

This claim by Respondents shows a remarkable degree of institutional amnesia, for the fact is that the Commissioner of Revenue routinely moved to dismiss for lack of jurisdiction constitutional claims filed in Tax Court subsequent to *McCannel* and *Guilliams*.[5] The Commissioner moved, for example, to dismiss the appeal brought in *Erie Mining*, but the Tax Court retained jurisdiction solely because the case had been filed prior to *Guilliams*. On appeal, the Minnesota Supreme Court affirmed this holding, reiterated that no jurisdiction existed post-*Guilliams*, and in dictum *for the first time* announced a procedure whereby a constitutional issue could be decided by the Tax Court if the court first referred the case to a district court and if the district court then referred it back to the Tax Court.[6] *Erie Mining*, 343 N.W.2d at 264. Citing *Nagaraja*, Respondents claim that the Petitioners

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[5] In response to these motions, the Tax Court held that it would retain jurisdiction of any appeal filed prior to *McCannel* and *Guilliams*. *Erie Mining Co. v. Commissioner of Revenue*, No. 2630 (Minn. Tax Ct. 1983), *aff'd on this ground*, 343 N.W.2d 261 (Minn. 1984); *Maland v. Commissioner of Revenue*, No. 3134 (Minn. Tax Ct. 1982); *and Hanson v. Commissioner of Revenue*, No. 2962 (Minn. Tax Ct. 1981). The court also held that it would retain jurisdiction over claims that a law "as applied" to a particular taxpayer was unconstitutional, as contrasted with claims questioning the constitutionality of a statute *per se*. *Fussard v. Commissioner of Revenue*, No. 3183 (Minn. Tax Ct. 1981). Since Petitioners challenged the constitutionality *per se* of the tax on federal obligation interest, their cases would have been dismissed for lack of subject matter jurisdiction if Petitioners had filed in Tax Court. *Cf. DeCoster v. Commissioner of Revenue*, No. 3207-S (Minn. Tax Ct. 1981) (Tax Court granted Commissioner's motion to dismiss claim that tax statute was unconstitutional).

[6] The Minnesota Supreme Court in a later case noted that "[i]t was not until our decision in [*Erie Mining*], however, that we specifically set out the procedure for enforcing the *McCannel* rule." *Soo Line Railroad Co. v. Commissioner of Revenue*, 377 N.W.2d 453, 456 n.1 (Minn. 1985).

somehow should have foreseen this circuitous procedure -- now referred to by the cognoscenti as the "*Erie* shuffle" -- prior to the *Erie Mining* decision. (Resp. Br. 14.) Respondents fail to note, however, that they themselves objected to the shuffle in *Nagaraja*. 352 N.W.2d at 374 n.1. Moreover, *Nagaraja* was a *refund* case, not a deficiency case, and therefore is inapposite to Respondents' claim that "Minnesota law clearly allowed an appeal to its tax court *without* prepayment." (Resp. Br. 14.) That claim is patently incorrect.

III. The Estoppel Holding of the Minnesota Supreme Court Is Unconstitutional.

Respondents claim that Petitioners "were forced to assert [that state obligation] exemptions were unlawful." (Resp. Br. 24.) To the contrary, Petitioners have consistently asserted that Minnesota's exemptions for its own bonds were lawful. Under federal constitutional and statutory law, the states are free to exempt state obligation interest from tax, and most states do so. 1 Multistate Corporate Income Tax Guide (CCH) ¶ 75 (June, 1992). However, a state exempting its own bonds cannot impose a tax on federal obligation interest. Petitioners challenged Minnesota's tax on federal obligation interest, not the state obligation exemptions.

The cases cited by Respondents at page 22 of their brief stand for the proposition that one cannot retain the benefits of a statute while challenging one of its conditions. Minnesota's exemptions for state obligation interest, however, were not subject to a condition that the taxpayer pay a tax on federal obligation interest. *See* Minn. Stat. §§ 136.32 (1978) *and* 474.12 (Supp. 1979) (Pet. App. 74A-75A.) Thus, Petitioners should not have

been estopped from challenging the tax by the acceptance of benefits doctrine.[7]

Finally, Respondents make the puzzling suggestion that Petitioners would not have been estopped if they had proceeded with a prepayment appeal to the Minnesota Tax Court. (Resp. Br. 20.) However, it is beyond comprehension why, assuming Petitioners accepted "benefits" in a refund case, they would not also have accepted those same "benefits" in a prepayment case. In either case Petitioners would have excluded state obligation interest from income, and the only way in which Petitioners could have divested themselves of that purported "benefit" would have been to forego the exemption and pay a tax no one else had to pay on state obligation interest. It is for this reason that the estoppel holding of the Minnesota Supreme Court is unconstitutional. (Pet. Br. 22-23.)

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[7] It should be noted that each of the cases cited by Respondents involved the application of *federal* estoppel doctrine to defeat a federal right. The instant case, by contrast, involves an attempt to apply *state* estoppel doctrine to defeat a federal right. It should also be noted that, while Petitioners excluded state obligation interest from income as they were entitled to do under state law, they did not thereby "reduce" their tax liability (Resp. Br. 27) except in the purely hypothetical sense that they could instead have bought taxable bonds. However, in buying state obligations Petitioners had to accept lower interest rates. (Pet. App. 45A.) Thus, the benefit of the exemptions went to the issuers of state obligations, not to Petitioners. (Pet. Br. 23.)

IV. Conclusion.

For the reasons set forth above and in the Petition for Certiorari, Petitioners request that their Petition for Certiorari be granted.

Respectfully submitted,

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